Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1537

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C.I. REALTY INVESTORS,
Petitioner,

vs.

CITY INVESTING COMPANY, C.I. REALTY INVESTORS, C.I. PLANNING CORPORATION, WILLIAM POLK CAREY, JOHN L. GIBBONS, PETER C.R. HUANG, JAMES V. TOMAI, JR., ROBERT M. MORGAN, WILLIAM S. RENCHARD, FRED R. SULLIVAN, JAMES R. WEBB and REYNOLDS SECURITIES INC.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

TABLE OF CONTENTS

CASES CITED:

TABLE OF CONTENTS

CASES CITED:

TABLE OF CONTENTS

CASES CITED:

TABLE OF CONTENTS

CASES CITED:

AUTHORITIES CITED:

FEDERAL STATUTES CITED:

TABLE OF CONTENTS

APPENDIX

IN THE

SUPREME COURT OF UNITED STATES

OCTOBER TERM, 1977

No.

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C.I. REALTY INVESTORS,

Petitioner,

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CITY INVESTING COMPANY, C.I. REALTY INVESTORS, C.I. PLANNING CORPORATION, WILLIAM POLK CAREY, JOHN L. GIBBONS, PETER C.R. HUANG, JAMES V. TOMAI, JR., ROBERT M. MORGAN, WILLIAM S. RENCHARD, FRED R. SULLIVAN, JAMES R. WEBB and REYNOLDS SECURITIES, INC.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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Petitioner, Irving Mason, respectfully prays that a writ of certiorari issue to review the decision and judgment of the Court of Appeals for the Second Circuit in the above action.

OPINIONS BELOW

The opinion and judgment of the Second Circuit, not officially reported, is reproduced as Appendix A hereto. The judgment of the District Court is reproduced as Appendix B.

JURISDICTION

The opinion and judgment of the Second Circuit were filed on November 9, 1976. A timely petition for rehearing was denied by order of February 18, 1977 (Appendix D).

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. section 1254(1).

QUESTIONS PRESENTED

This petition arises from an order by Judge Wyatt of the United States District Court for the Southern District of New York, dismissing two counts of petitioner's complaint which alleged, *inter alia*, violations of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, derivatively on behalf of C.I. Realty Investors. These derivative causes of action were dismissed for failure to make a demand on the shareholders of the trust as required by Massachusetts law.

The broad issue raised here is the proper relationship of state corporation law vis-a-vis the congressional policy underlying the federal securities laws. That issue is presented more specifically by the following questions:

Whether the Courts below erred in holding that a shareholder of a Massachusetts corporation or business trust must first make a demand on all of the corporation's shareholders before being permitted to assert derivative claims on behalf of the corporation where:

(1) The derivative claims are grounded on the Securities Exchange Act of 1934;

(2) Such a requirement would be unreasonably burdensome and would confilict with federal policy; and

(3) The law of the transferor forum, which must be applied pursuant to *Van Dusen v. Barrack*, 376 U.S. 612 (1964), does not require a demand on the shareholders of a publicly held corporation as a condition precedent to bringing a derivative suit.

STATUTES AND RULES INVOLVED

The statutes and rules involved are:

Sections 10-b and 14-a of the Securities Exchange Act of 1934 and Rules 10b-5 and 14a-9 thereunder; and

Rule 23.1 Fed. R. Civ. P.

They are set forth in Appendix C.

STATEMENT OF THE CASE

Introduction

In an April 13, 1972, public offering, C.I. Realty Investors raised approximately $65,000,000 by selling 2,600,000 Units of the Trust's securities to the public at $25.00 per Unit. Each Unit contained one share of beneficial interest in the Trust and one warrant to purchase an additional share at $25.00. On April 13, 1972, petitioner Irving Mason purchased 1,000 units of the Trust for $25,000. The market value of each of the Trust's shares has since declined drastically, and they are presently trading at approximately $5.63 per share. The warrants are generally regarded as being worthless at this time.

On February 25, 1975, petitioner Mason filed a six count derivative and class action complaint in the United States District Court for the Eastern District of Pennsylvania alleging violations of various provisions of the federal

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securities laws, as well as pendent state law claims. On March 20, 1975, the action was transferred by consent to the Southern District of New York pursuant to 28 U.S.C. Section 1404(a).

Respondent C.I. Realty Investors is a Real Estate Investment Trust organized pursuant to Massachusetts law under a declaration of trust dated November 10, 1971, as amended on April 3, 1972. The shares of the Trust are registered with the Securities and Exchange Commission pursuant to Section 12 of the Exchange Act. The Trust's shares have been traded on the over-the-counter market and, since December 12, 1973, on the New York Stock Exchange.

The Amendment Complaint

Petitioner filed an amended complaint on November 19, 1975. The defendants named in the amended complaint, in addition to the Trust, are: City Investing Company, a corporation that controls the Trust and the Trust's advisor; C.I. Planning Corporation, an indirectly wholly owned subsidiary of City Investing Company which served as advisor to the Trust; eight individual trustees of the Trust; and Reynolds Securities, Inc., one of the two managing underwriters of the Trust's public offering of April 13, 1972.

Counts I, II and III of the amended complaint allege class action claims for violations by the defendants of Sections 10(b) and 13(a) of the Exchange Act and Rules 10b-5, 13a-1, 13a-11, and 13a-13 promulgated thereunder, as well as Sections 12(2) and 17(a) of the Securities Act of 1933 ("Securities Act") in connection with the preparation of the registration statement and issuance of the prospectus for the public offering of the Trust's shares commencing April 13, 1972. Count VI alleges class action claims for violations of state law against all defendants except the Trust and Reynolds Securities, Inc. Counts I, II, III and VI are collectively referred to as the class action counts.

Count IV alleges violations of Sections 10(b) and 14(a) of the Exchange Act and Rules 10b-5 and 14a-9 promulgated thereunder, derivatively on behalf of the Trust against all of the defendants except Reynolds Securities, Inc. Count V alleged violations of the state fraud, self-dealing, conflict of interest and breach of fiduciary duty laws derivatively on behalf of the Trust against all of the defendants except Reynolds Securities, Inc.

The Motions Below

On December 12, 1975, defendants moved to stay the class action counts on the ground that they were duplicative of those in *David Steinberg, et al. v. William Polk Carey, et al.*, 75 Civ. 1695 (IBW), a related action which was also being actively litigated. Defendants also moved to dismiss the derivative counts on the grounds that plaintiff had failed to make demand upon the Trust's shareholders as required by Massachusetts law and that plaintiff could not properly maintain a derivative suit on behalf of the Trust at the same time he was prosecuting a class action against the Trust.

The District Court's Order

On May 3, 1976, the District Court issued an order staying the class action counts pending a final determination of the *Steinberg* action, and dismissing the derivative causes of action on the ground that petitioner had failed to make a demand on the shareholders of the Trust as required by applicable Massachusetts law. The District Court declined to hold that it was obligated to apply the law of the Eastern District of Pennsylvania, the transferor court,

on this issue. The District Court also made an express determination that there was no just reason for delay and pursuant to Fed. R. Civ. P. Rule 54(b) entered final judgment in favor of the defendants (Appendix B).

On May 27, 1976, petitioner filed a timely notice of appeal to the Second Circuit from the District Court's judgment.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the decision of this Court in *J.I. Case v. Borak*, 377 U.S. 426 (1964).

The rulings below require the petitioner to make demand upon the shareholders prior to instituting suit in federal court to redress violations of federal securities laws. By imposing a burdensome and futile state procedural requirement as a prerequisite to this suit, the decision conflicts with *J.I. Case v. Borak*, 377 U.S. 426, 434-35 (1964). This Court there discussed the relationship of state corporation law vis-a-vis federally protected rights:

> [W]e believe that the overriding federal law applicable here would, where the facts required, control the appropriateness of the redress *despite the provisions of state corporation law*, for it "is not uncommon for federal courts to fashion federal law where federal rights are concerned."
>
> • • • •
>
> And if the law of the State happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated. Furthermore, the hurdles that the victim might face (such as separate suits, as contemplated by Dann v. Studebaker-Packard Corp., supra, security for expenses statutes, bringing in all parties necessary for complete relief, etc.) might well prove insuperable to effective relief. (emphasis added)

Here there can be no doubt that the shareholder demand requirement will "prove insuperable" to a derivative suit to redress violations of federal securities laws. Federal law, not state law, must govern the enforcement of federal rights. *See Tcherepnin v. Knight*, 389 U.S. 332, 337-38 (1967); *In re Pittsburgh & Lake Erie R.R. Co. Sec.*

& Antitr. Lit., 543 F.2d 1058, 1064-67 (3rd Cir. 1976); *Drachman v. Harvey*, 453 F.2d 722, 727-30 (2d Cir. 1971) *aff'd in part, rev'd in part on other grounds*, 453 F.2d 736 (1972) (en banc); *Levitt v. Johnson*, 334 F.2d 815 (1st Cir. 1964), *cert. denied* 379 U.S. 961 (1965); *Jannes v. Microwave Communications*, 57 F.R.D. 18 (N.D. Ill. 1972); *Dopp v. American Electronics*, 55 F.R.D. 151, 155 (S.D.N.Y. 1972).

2. There exists a conflict in the Law of the Circuits regarding the important issue raised herein.

This petition raises the sensitive issue of the proper role of state corporation regulations in the remedial scheme of the federal securities laws. In the instant case, the decision below requires a plaintiff, prior to filing suit in federal court to enforce a right conferred upon him solely by the federal securities laws and exclusively lodged in the federal courts, to abide by a state law requiring a demand upon shareholders. This, no matter how burdensome or futile the procedure may be.

In dismissing the derivative counts of petitioner's complaint, the courts below relied on *Brody v. Chemical Bank*, 482 F.2d 1111 (2d Cir.), *cert. den.* 414 U.S. 1104 (1973) and *Jones v. The Equitable Life Assurance Society*, 409 F. Supp. 370 (S.D.N.Y. 1975). These cases hold that where, as here, a derivative action is instituted pursuant to Federal Rule of Civil Procedure 23.1, the federal courts will look to state law to determine whether a demand on stockholders is necessary. *Brody, supra, at* 1114; *Jones, supra at* 374.

A decision directly in conflict with these decisions was rendered by the First Circuit Court of Appeals. There the court which encompasses the Commonwealth of Massachusetts was presented with the identical issue of whether

plaintiffs in a derivative lawsuit were required, under Rule 23.1 of the Federal Rules of Civil Procedure, to make a demand on the shareholders of a Massachusetts corporation before bringing suit under the federal securities laws. The court held that such demand was not required despite the provisions of Massachusetts law. *Levitt v. Johnson*, 334 F.2d 815 (1st Cir. 1964), *cert. denied* 379 U.S. 961 (1965).

The Court in *Levitt* distinguishes its earlier decision of *Halprin v. Babbitt*, 303 F.2d 138 (1st Cir. 1962) (holding that the minority must demand upon the majority), as follows: "In Halprin . . . 92% of the company's stock was held by one stockholder. We were not, in other words, speaking in the context of 48,000 stockholders, or as to when such a circumstance might constitute an excuse." 334 F.2d at 817. Most importantly, the court further stated that: "Nor does Halprin, which was a diversity case, answer the question of what law presently governs." 334 F.2d at 817.

The court specifically disapproved of the lower court's holding that state law applies "even if the claim which the corporation has against the alleged wrongdoers is based on a federal statute." Indeed, the First Circuit in *Levitt* specifically held that Massachusetts state law was irrelevant:

> "We need not pursue the inquiry of whether the Massachusetts law is otherwise, because if it is, it should not, in our opinion, be applied." 384 F.2d at 819.

Recognizing the important congressional policy underlying the securities laws, the *Levitt* court held that it could "not see how it can be gainsaid that any substantial stiffening of the conditions precedent to the bringing of stockholders' suits above normal requirements would conflict with this broad declaration (of national policy)." 334 F.2d at 819. As the court continued:

> "The district court's reasoning that since the stockholder's right is a derivative one, his right to bring suit must be controlled by the local law of the state of incorporation in the absence of an explicit congressional direction to the contrary negates the intendment of the act and underestimates the role to be played by the federal courts in the implementation of national regulatory legislation. See Note, 50 Va. L. Rev. 365 (1964)." 334 F.2d at 819.

In so holding, the *Levitt* court relied on this Court's decision in *J.I. Case Co. v. Borak, supra.*

The law of the First Circuit then, is that a state law requiring a shareholder demand does not control in derivative suits grounded on the federal securities laws. The *Levitt* decision has received widespread acceptance by the commentators.[1]

The Third Circuit, too, has taken a position in conflict with the Courts below. In discussing the standing of a trustee of bondholders to object to a settlement of a class and derivative settlement, the Circuit stated:

> We conclude that standing in a Rule 23.1 case to assert a derivative claim based on federal law *is a federal law question*, and that for the same reasons standing to object to the settlement of such a claim is a federal law question.

In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitr. Lit., supra, at 1067 (emphasis added).

1. E.g., Note, 78 Harv. L. Rev. 1476 (1965); Note, 50 Va. L. Rev. 365 (1964) (criticizing the lower court decision in *Levitt* since overturned by the First Circuit). See also, *Bromberg*, Fraud-SEC Rule 10b-5 Section 11.7 (1975); Bloomenthal, Securities and Federal Corporate Law, Section 11.20(2) (1974); 7A Wright & Miller, Federal Practice and Procedure: Civil Section 1832 (1972); 13 Fletcher Cye. Corp. Section 5970 at 385 (1970 Revised Ed.); Loss, Securities Regulation, Vol. II at 951 (1961), as supplemented, Vol. V at 2920 (1969); Carey, Cases on Corporations, 4th Ed. at 341 (1969).

Such a position is in complete accord with that asserted by petitioner. In a derivative suit asserting violations of the federal securities laws, the Court should look to federal law in determining the necessity for a demand on stockholders.

In a closely analogous situation, the Third Circuit has held that a plaintiff in a derivative suit alleging violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(b) did not have to comply with state security for costs statutes. *McClure v. Borne Chemical,* 292 F.2d 824 (3d Cir.), *cert. denied* 368 U.S. 939 (1961). Indeed, the Third Circuit in *Rodgers v. American Can Co.,* 305 F.2d 297 (3rd Cir. 1962) in perhaps the most exhaustive analysis of the issue presented in this petition, held that even though the shareholders of a corporation had refused to authorize a lawsuit after demand upon them, such refusal could not stop a derivative plaintiff in his attempt to correct violations of federal law. Clearly the Third Circuit would not require a party to pursue a meaningless formality prior to suit. *See Weiss v. Sunasco, Inc.,* 316 F. Supp. 1197 (E.D. Pa. 1970).

The prevailing view from a District Court in the Seventh Circuit too, is in conflict with the rulings below. Senior Judge Robson (then Chief Judge), was presented with the same issue in *Jannes v. Microwave Communications, Inc.,* 57 F.R.D. 18 (N.D. Ill. 1972). In *Jannes* the parties disagreed as to whether Illinois law required a demand on shareholders. The court refused to even consider Illinois law, holding:

> "The parties discuss at some length whether Illinois law would require a demand on the shareholders under the circumstances of this suit, but this court is of the opinion that federal common law controls. Although speaking of whether a federal cause of action was created by violation of Section 14(a) of

the Securities Exchange Act, the comment of the Supreme Court is that '. . . the overriding federal law applicable here would, where the facts required, control the appropriateness of redress despite the provisions of state corporation law, for it "is not uncommon for federal courts to fashion federal law where federal rights are concerned."' *J.I. Case Co. v. Borak*, 377 U.S. 426, 434, 84 S. Ct. 1555, 1561, 12 L. Ed. 2d 423 (1964). *Furthermore, one reason that federal jurisdiction is necessary in order to effectuate the Securities Exchange Act is to avoid state law hurdles which 'might well prove insuperable to effective relief.' Id.* at 435, 84 S. Ct. at 1561. In connection with Sec. 14(a) there is authority that whether a shareholder demand is necessary is 'clearly' a matter of federal law. 2 Loss, Securities Regulation 951 (1961). This court can discern no reason why Section 10(b) should be interpreted differently from Section 14(a) of the same act." 57 F.R.D. at 22 (emphasis added).

In addition to state shareholder demand requirements and security for expenses laws, the federal courts have held other provisions of state law to be inapplicable or irrelevant to actions grounded on the federal securities statutes. *Wolf v. Frank*, 477 F.2d 467 (5th Cir. 1973), *cert. denied* 414 U.S. 975 (1973) (allowance of prejudgment interest with 10b-5 damage award); *Fields v. Fidelity Gen. Ins. Co.*, 454 F.2d 682 (7th Cir. 1971) (dictum that a derivative 10b-5 action may be maintained despite the lack of authority to sue from state court supervising corporate liquidation); *Drachman v. Harvey*, 453 F.2d 722 (2d Cir. 1971), *aff'd in part and rev'd in part on other grounds*, 453 F.2d 736 (1972) (*en banc*) (standing of an equitable stockholder to bring a derivative 10b-5 action); *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100 (5th Cir. 1970), *cert. denied* 402 U.S. 988 (1971) (10-b civil action does not require the application of state substantive law of fraud); *Myzel v.*

Fields, 386 F.2d 718 (8th Cir. 1967), *cert. denied* 390 U.S. 951 (1968) (election of remedies doctrine); *Gilson v. Chock Full O'Nuts Corp.*, 331 F.2d 107 (2d Cir. 1964) (*en banc*) (award of attorney fees for merely prompting corporation to bring an action under Section 16(b) of the Exchange Act); *Globus, Inc. v. Law Research Service, Inc.*, 318 F. Supp. 955, 958 n.2 (S.D.N.Y. 1970) (contribution and indemnification for violations of federal securities laws), *aff'd* 442 F.2d 1346 (2d Cir.), *cert. denied* 404 U.S. 941 (1971); *Hall v. American Cone & Pretzel Co.*, 71 F. Supp. 266 (E.D. Pa. 1947) (non-interference with foreign corporation doctrine). Similarly, the courts have also held that the definition of the various terms used in the federal securities statutes are dependent on federal law and the policy underlying these statutes and not on the contrary provisions of state law. *E.g., Tcherepnin v. Knight*, 389 U.S. 332 (1967); *Champion Home Builders Co. v. Jeffress*, 490 F.2d 611 (6th Cir. 1974), *cert. denied* 416 U.S. 986 (1974); *S.E.C. v. Sterling Precision Corp.*, 393 F.2d 214 (2d Cir. 1968).

Not only is the decision below in direct conflict with the law of the First and Third Circuits, but it also ignores the prevailing precedent regarding the history and purpose of the federal securities laws.

3. State corporate law which conflicts with the overriding federal interest in the protection of the investing public cannot control litigation under the Exchange Act.

In discussing the intent of Congress in passing the various federal securities laws including the Exchange Act,[2] upon which Count IV of appellant's Complaint is grounded, this Court noted:

2. 48 Stat. 881, as amended, 15 U.S.C. Section 78a *et seq.*

> ["All of these statutes were] designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. . . . A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'it requires but little appreciation*** of what happpened in this country during the 1920's 1930's to realize who essential it is that the highest ethical standards prevail' in every facet of the securities industry."

S.E.C. v. Capital Gains Research Bureau, 375 U.S. 180, 186-7 (1963) (citations omitted). *Accord, Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972). It is thus well settled that, as with all remedial legislation, the Exchange Act is to be construed to effectuate its purposes, central of which is the protection of the investing public through disclosure, as well as strong civil and criminal penalties to prevent and punish fraud. *E.g., Affiliated Ute, supra; Tcherepnin v. Knight*, 389 U.S. 332 (1967); *Crane v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied* 400 U.S. 822 (1970); *Columbia General Investing Corp. v. S.E.C.*, 265 F.2d 559 (5th Cir. 1959).

In light of this overriding Congressional concern with the protection of the investing public, the federal courts are to fashion appropriate remedies to effectuate this Congressional purpose despite the contrary provisions of state corporate law which may limit the nature of available remedies. *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964). In holding that the Exchange Act authorizes a federal cause of action for rescission or damages, the Court in *J.I. Case Co.* expressly stated that if victims of deceptive proxy statements were obliged to seek relief in the state courts, the purpose of Section 14 of the Exchange Act would be frustrated if the state either attached no responsibility to the use of misleading proxy statements or placed various procedural hurdles which could "well prove insuperable to effective relief." *Id.* at 434-5

These reservations would apply with even more force if these state procedural or substantive hurdles (such as mandatory demand on the stockholders in all cases) were held to apply under Rule 23.1 to derivative suits in federal court under the federal securities laws. Indeed, the special Congressional protection would be of no avail to derivative plaintiffs, as the District Court's order would suggest, any one state or group of states could frustrate the purpose of these statutes by enacting burdensome conditions precedent to the maintenance of derivative suits.

Furthermore, it is unrealistic to claim that since a stockholder's right to sue derivatively on behalf of his corporation arises from state law, that the "necessity" under Rule 23.1 [3] of a demand on the body of stockholders would also depend on state law. Rather, it is just the opposite. The stockholder's derivative suit and the limitations upon its use were initially developed by the federal courts as part of their powers as courts of equity. *Fielding v. Allen*, 181 F.2d 163, 167-8 (2d Cir.), *cert. denied sub nom Ogden Corp. v. Fielding*, 340 U.S. 817 (1950). *Accord, McClure v. Borne Chemical Co.*, 292 F.2d 824, 832-34 (3d Cir.), *cert. denied* 368 U.S. 939 (1961); *see Hawes v. City of Oakland*, 104 U.S. 450 (1882). Indeed, a shareholder's

3. Rule 23.1 only requires a demand on the shareholders "if necessary." This "if necessary" qualification has been interpreted as referring the federal court to the substantive law upon which the suit is grounded—that is federal law in the instant case. *Jannes v. Microwave Communications, Inc.*, 57 F.R.D. 18 (N.D. Ill. 1972); 7A Wright & Miller, Federal Practice and Procedure: Civil Section 1832 at 385 (1972).

right to "maintain a derivative action on a corporate right federal in nature is federally conferred." *Fielding, supra; McClure, supra.* Mindful of the overriding federal interest in obtaining a high standard of business ethics in the securities industry as well as the equitable origin of the derivative suit in federal court, the overwhelming number of courts which have decided this issue have held that the demand on the stockholders requirement embodied in state law will not control where that law would harm the federal interests receiving expression in the derivative right sought to be enforced. *Levitt v. Johnson,* 334 F.2d 815 (1st Cir. 1964), *cert. denied* 379 U.S. 961 (1965); *Phillips v. Bradford,* 62 F.R.D. 681 (S.D.N.Y. 1974); *Jannes v. Microwave Communications, Inc.,* 57 F.R.D. 18 (N.D. Ill. 1972); *Dopp v. American Electronic Lab's, Inc.,* 55 F.R.D. 151, 155 and n.10 (S.D.N.Y. 1972); *see In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitr. Lit., supra; Drachman v. Harvey, supra; McClure v. Borne Chemical Co.,* 292 F.2d 824 (3rd Cir. 1961).

In the instant situation, federal law should determine the necessity for shareholder demand.

4. This court should decide the question of whether the rationale underlying *Van Dusen v. Barrack,* 376 U.S. 612 (1964) determines the interpretation of *federal* law which the transferor district would apply.

It is well settled that if a case is transferred pursuant to 28 U.S.C. Section 1404(a), the state law of the transferor forum, not the transferee forum, must apply. *Van Dusen v. Barrack,* 376 U.S. 612, 639 (1964):

> "We conclude. . . that in cases such as the present where the defendants seek transfer, the transferee district court must be obligated to apply the state law that would have been applied if there had been no change of venue. A change of venue under Section 1404(a) generally should be, with respect to state law, but a change of courtrooms."

The question raised by this petition, however, is whether this same rationale should apply to mandate that the interpretation of *federal* law which exists in the transferor forum, should be binding on the transferee court. *Compare, Berry Petroleum Co. v. Adams & Peck,* 518 F.2d 402, 408 and n.7 (2d Cir. 1975); *In re Air Crash Disaster at Boston, Mass.,* 399 F. Supp. 1106, 1108 (D. Mass. 1975); *In re Four Seasons Sec. Lit.,* 370 F. Supp. 219 (W.D. Oke. 1974); *In re Plumbing Fixtures Lit.,* 342 F. Supp. 756 (JPML 1972); *Philadelphia Housing Auth. v. American Radiator & Standard Sanitary Corp.,* 309 F. Supp. 1053 (E.D. Pa. 1969) *with Scheinbart v. Certain-Teed Products Corp.,* 367 F. Supp. 707, 711 (S.D.N.Y. 1973); *H.L. Green Co. v. MacMahon,* 312 F.2d 650 (2d Cir. 1962), *cert. denied* 372 U.S. 928 (1963).

With the widespread practice of transfers under Sections 1404 and 1407 and the increased frequency of involuntary consolidations and transfers by the Judicial Panel on Multidistrict Litigation, this Court should decide this issue. *See In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitr. Lit.,* 543 F.2d 1058, 1065, n.19 (3rd Cir. 1976).

CONCLUSION

For the reasons set forth above, Petitioner respectfully prays that this Court issue its Writ of Certiorari so as to bring before it for briefing and argument the questions of federal law presented.

Respectfully submitted,

/s/ Richard D. Greenfield
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APPENDIX A

UNITED STATES COURT OF APPEALS

for the

Second Circuit

76-7258

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C. I. Realty Investors,
Plaintiffs-Appellants,

vs.

CITY INVESTING COMPANY, et al.,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT OF THE SOUTHERN DISTRICT OF NEW YORK

(Filed November 9, 1976)

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is *affirmed* on the ground that plaintiff has failed to make a demand pursuant to Fed. R. Civ. P. 23.1 upon the shareholders of defendant C.I. Realty Investors as required by Massachusetts law. See *Brody v.*

Chemical Bank, 482 F.2d 1111 (2d Cir. 1973); *Jones v. Equitable Life Assurance Society*, 409 F. Supp. 370 (S.D. N.Y. 1975).

/s/ Paul R. Hays
PAUL R. HAYS

/s/ Robert P. Anderson
ROBERT P. ANDERSON

/s/ William H. Timbers
WILLIAM H. TIMBERS
Circuit Judges

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
75 Civ 1811 (IBW)

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C.I. REALTY INVESTORS,

Plaintiff,

vs.

CITY INVESTING COMPANY, *et al.*,

Defendants.

ORDER AND FINAL JUDGMENT
(Filed May 3, 1976)

Defendants City Investing Company, C.I. Realty Investors, C.I. Planning Corporation, John L. Gibbons, Peter C. R. Huang, James V. Tomai, Jr., William S. Renchard, Fred R. Sullivan and Reynolds Securities Inc. having moved this court for an order staying Counts I, II, III and VI of the Amended Complaint on the grounds that the prosecution of the instant case concurrently with that of *Steinberg v. Carey* 75 Civ 1695(IBW) results in needless expenditure of the resources and time of defendants and the Court since both actions are virtually identical and dismissing Counts IV and V of the Amended Complaint on the grounds that Plaintiff has failed to make upon the security holders of defendant C.I. Realty Investors as required by Massachusetts law and on the grounds that Plaintiff cannot prop-

erly maintain a suit derivatively on behalf of defendant C.I. Realty Investors at the same time he is prosecuting direct claims against such defendant, and oral argument on these motions having been heard, IT IS HEREBY ORDERED, Adjudged and Decreed:

A. That all proceedings and discovery in connection with Counts I, II, III and VI of the Amended Complaint herein (the direct claims) are stayed until final determination of the related case of *Steinberg v. Carey*, 75 Civ 1695 (IBW) and

B. That Counts IV and V of the amended complaint herein (the derivative claims) are dismissed on the grounds that Plaintiff has failed to make demand upon the share holders of defendant C.I. Realty Investors as required by Massachusetts law.

The Court having made an express determination that there is no just reason for delay, IT IS FURTHER ORDERED that pursuant to Rule 54(b) of the Federal Rules of Civil Procedure entry of a final judgment in favor of defendants is hereby expressly directed as to Counts IV and V (the derivative claims).

/s/ Inzer B. Wyatt
INZER B. WYATT, U.S.D.J.

DATED: New York, N.Y.
May, 3, 1976

APPENDIX C
STATUTES AND RULES INVOLVED

FEDERAL RULES OF CIVIL PROCEDURE

Rule 23.1

DERIVATIVE ACTIONS BY SHAREHOLDERS

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

SECURITIES EXCHANGE ACT OF 1934
15 USC Secs. 78a-78jj as amended

REGULATION OF THE USE OF MANIPULATIVE AND DECEPTIVE DEVICES

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange–

(b) To use oh employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
15 USC Sec. 78j.

PROXIES

Sec. 14. (a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.
15 USC Sec. 78n.

SECURITIES AND EXCHANGE COMMISSION
Rules under the Securities Exchange Act of 1934

Rule 10b-5

Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
17 CFR §240.10b-5

Rule 14a-9

False or Misleading Statements

(*a*) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.
17 CFR §240.14a-9

APPENDIX D

UNITED STATES COURT OF APPEALS

for the

Second Circuit

77-7258

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C. I. Realty Investors,

Plaintiff-Appellants,

vs.

CITY INVESTING COMPANY, et al.,

Defendants-Appellees.

A petition for a rehearing having been filed herein by counsel for the PLAINTIFF-APPELLANT,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

/s/ A. Daniel Fusaro
Clerk

(Filed February 18, 1977)

Supreme Court, U. S.
FILED
JUN 29 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1537

IRVING MASON, on behalf of himself and all others similarly situated, and derivatively on behalf of C. I. REALTY INVESTORS,

Petitioner,

v.

CITY INVESTING COMPANY, C. I. REALTY INVESTORS, C. I. PLANNING CORPORATION, WILLIAM POLK CAREY, JOHN L. GIBBONS, PETER C. R. HUANG, JAMES V. TOMAI, JR., ROBERT M. MORGAN, WILLIAM S. RENCHARD, FRED R. SULLIVAN, JAMES R. WEBB, and REYNOLDS SECURITIES, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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INDEX

Table of Authorities

Cases

Statutes and Rules

Other Authorities

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Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

Questions Presented

1. Whether the shareholders of C. I. Realty Investors are entitled to the protection provided by Fed. R. Civ. P. 23.1 and applicable Massachusetts law, which require a plaintiff to consult with his fellow shareholders before bringing a derivative suit under the federal securities laws.

2. Whether a federal district court in a case brought under the federal securities laws is required to look to the federal law of the transferor forum in applying Fed. R. Civ. P. 23.1 following a transfer by consent pursuant to 28 U.S.C. § 1404(a).

STATEMENT OF THE CASE

A. The Parties

Respondent C. I. Realty Investors ("CIRI" or the "Trust") is a real estate investment trust organized under and pursuant to the laws of Massachusetts. Its shares are listed on the New York Stock Exchange. Respondent C. I. Planning Corporation, an indirectly, wholly-owned subsidiary of Respondent City Investing Company, is CIRI's investment advisor. The individual Respondents are past or present members of CIRI's Board of Trustees. Reynolds Securities, Inc. was one of the underwriters for the Trust's public offering in 1972.

Petitioner Irving Mason allegedly purchased 1,000 Units of CIRI, each containing one Share of Beneficial Interest and one Warrant to purchase one Share.

B. The Amended Complaint

The original complaint in this action, containing both class action and derivative claims, was filed on February 26, 1975 in the United States District Court for the Eastern District of Pennsylvania. The complaint closely paralleled another complaint filed against the same defendants two months before in the same court entitled *David Steinberg et al.* v. *William Polk Carey et al.*, 75 Civ. 1695 (I.B.W.).*

* Counsel for plaintiffs in this action are also counsel for plaintiffs in the *Steinberg* action.

Both actions were subsequently transferred on consent to the United States District Court for the Southern District of New York.

On November 19, 1975 petitioner served an amended complaint. The class action claims, counts I-III and VI, relate to alleged omissions and misrepresentations in the Trust's April 13, 1972 Prospectus and certain additional unspecified documents. The derivative claims herein, counts IV and V, incorporate by reference the factual averments in the first three class action counts and add general conclusory claims of personal enrichment by the respondents. Count IV alleges violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 adopted thereunder and Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n, and Rule 14a-9 adopted thereunder. Count V is brought pursuant to the court's pendent jurisdiction.

C. The Motions Below

On December 12, 1975 respondents moved to stay the class action counts herein on the ground that they were duplicative of those in the *Steinberg* action which were being actively litigated. Respondents also moved to dismiss the derivative counts on the grounds that petitioner had failed to consult with CIRI's shareholders as required by Fed. R. Civ. P. 23.1 and that petitioner could not properly maintain a derivative suit on behalf of the Trust at the same time he was prosecuting a class action against the Trust.

D. The Opinions Below

On May 3, 1976 the United States District Court for the Southern District of New York (Wyatt, J.) issued an order staying the class action counts pending a final determina-

tion of the *Steinberg* action, and dismissing the derivative causes of action on the ground that petitioner had failed to make a demand on the shareholders of CIRI as required by Fed. R. Civ. P. 23.1 and applicable Massachusetts law. The District Court declined to hold that it was obligated to apply the law of the United States District Court for the Eastern District of Pennsylvania, the transferor court, on this issue. The District Court made an express determination that there was no just reason for delay and pursuant to Fed. R. Civ. P. 54(b) entered final judgment in favor of the respondents (Pet., App. B).

On November 9, 1976 the United States Court of Appeals for the Second Circuit unanimously affirmed the order of the District Court (Pet., App. A). On February 18, 1977, the Court of Appeals denied petitioner's petition for rehearing (Pet., App. D).

REASONS FOR DENYING THE WRIT

I.

The Second Circuit Court of Appeals Correctly Decided That Rule 23.1 Requires Petitioner, as a Condition to Maintaining This Derivative Action, to Comply with Applicable Massachusetts Law Requiring Demand on Shareholders.

A. The Rationale and Judicial History Rule 23.1 Support Shareholder Demand in this Case

Fed. R. Civ. P. 23.1 provides in pertinent part:

> "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority *and, if necessary, from the shareholders or*

> *members, and the reasons for his failure to obtain the action and for not making the effort.*" [Emphasis added.]

1. *The Rule Is an Expression of Long Standing Judicial Policy*

The judicial history of this Rule demonstrates a federal policy that shareholders of a corporation are entitled to decide in the first instance when and under what terms their corporation will become involved in litigation. The Rule recognizes that modern litigation is an extremely time-consuming and expensive proposition, and affords shareholders substantial protection from a plaintiff who, under the guise of being a representative party, would bring a suit purportedly on behalf of the corporation, often in the hope of coercing a quick settlement. Equally important, it expresses the right of a corporation's shareholders in the exercise of their sound business judgment *not* to authorize an action of dubious merit. Conversely, if an action has merit, the Rule gives the shareholders the right to take over the litigation themselves or to direct the corporation to prosecute. Petitioner would have this protection eliminated.

The federal requirement of shareholder demand has its genesis in the Supreme Court's decision in *Hawes* v. *Oakland*, 104 U.S. 450 (1882). There, a shareholder of the Contra Costa Water-works Company sought to maintain a suit on behalf of the corporation against the city of Oakland, California. The Court held that the plaintiff-shareholder was required in the first instance to present its case to all the shareholders of the corporation and explained the reasoning behind this conclusion by quoting from the case of *MacDougall* v. *Gardiner*, 1 Ch. D. 13 (1875):

"Because there may be a great many wrongs committed in a company,—there may be claims against directors, there may be claims against officers, there may be claims against debtors; there may be a variety of things which a company may well be entitled to complain of, but which, *as a matter of good sense,* they do not think it right to make the subject of litigation; and it is the company, as a company, which has to determine whether it will make anything that is a wrong to the company a subject-matter of litigation, or whether it will take steps to prevent the wrong from being done." 104 U.S. at 457. [Emphasis added.]

The Court thus explicitly recognized that there may be situations where the shareholders of a corporation are entitled to exercise their sound business judgment and decide not to prosecute a claim that could arguably be brought. *See also, Corbus* v. *Alaska Treadwell Gold Mining Co.,* 187 U.S. 455 (1903).

2. *The Rule Is Applied in Connection with the Enforcement of Federally Created Rights*

The right of shareholders to be consulted has also been applied by the Supreme Court in cases where there have been claimed violations of federal laws. In *United Copper Securities Co.* v. *Amalgamated Copper Co.,* 244 U.S. 261 (1917), plaintiff brought a stockholders derivative action based on alleged violation of the Sherman Act, 15 U.S.C. § 1, *et seq.* The Court, in an opinion by Mr. Justice Brandeis, held that the suit could not be maintained absent an application to the corporation's shareholders:

"No application appears to have been made to the stockholders as a body or indeed to any other stockholders individually; nor does it appear that there

was no opportunity to make it, and no special facts are shown which render such application unnecessary. For aught that appears, the course pursued by the directors has the approval of all the stockholders except the plaintiffs. *The fact that the cause of action is based on the Sherman Law does not limit the discretion of the directors or the power of the body of stockholders; nor does it give to individual shareholders the right to interfere with the internal management of the corporation.*" 244 U.S. at 264. [Emphasis added.]

3. *The Courts Have Traditionally Looked to State Law on the Issue of Intracorporate Remedies*

Since the Federal Rules are silent on when and under what circumstances shareholder demand is required, Federal Courts have traditionally looked to state law for the substance of the shareholder demand requirement. This approach recognizes that there are no federal articles of incorporation and that the primary responsibility for the regulation of the internal affairs of state-created corporations resides with the states themselves.

The traditional rule is that the law of the state of incorporation determines the rights of a shareholder to participate in the affairs of the corporation:

"The local laws of the state of incorporation will be applied to determine the right of a shareholder to participate in the administration of the affairs of the corporation . . . ." Restatement (Second), Conflict of Laws § 304 (1971).

This rule is based on the principle that all the shareholders of a nationwide corporation are entitled to have their rights and obligations governed by a single body of readily ascertainable law. Since the states have historically

taken the primary responsibility for the regulation of corporations, the federal courts have not attempted to create a federal common law governing corporations. *See,* Restatement (Second), Conflict of Laws, § 304, Comment C (1971); Ehrenzweig, *Conflict of Laws,* § 12 at 38 (1962).

It was this guiding principle which caused Mr. Justice Douglas in *Price* v. *Gurney,* 324 U.S. 100, 106 (1945), to look to the law of the state of incorporation to determine whether shareholders of an Ohio corporation could file an action in Federal Court asking relief under Chapter X of the Bankruptcy Act, 11 U.S.C. § 501:

> "The District Court in passing on petitions filed by corporations under Chapter X must of course determine whether they are filed by those who have authority so to act. In absence of federal incorporation, that authority finds its source in local law. If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition. It is not enough that those who seek to speak for the corporation may have the right to obtain that authority."

This principle was reiterated in *Cohen* v. *Beneficial Industrial Loan Corp.,* 337 U.S. 541, 549-550 (1949), which although expressed in the context of a diversity action, nonetheless sets forth the Court's view that state law should govern intracorporate relationships:

> "The very nature of the stockholder's derivative action make it one in the regulation of which the legislature of a state has wide powers. Whatever theory one may hold as to the nature of the corporate entity, it remains a wholly artificial creation whose internal relations between management and stockholders are dependent upon state law and may be subject to most complete and penetrating regulation, either by public authority or by some form of stockholder action . . . ."

It was against this judicial background that the Court of Appeals made its decision below.

B. Massachusetts Law Requires Demand on Shareholders

The law of Massachusetts, applied by the Court of Appeals in its decision below, has long required a demand on shareholders as a precondition to bringing a derivative suit on behalf of a Massachusetts corporation. *Brody* v. *Chemical Bank,* 482 F.2d 1111 (2d Cir.), *cert. denied,* 414 U.S. 1104 (1973); *Clairdale Enterprises, Inc.* v. *C. I. Realty Investors,* 75 Civ. 4227 (S.D.N.Y. June 21, 1976) (applying Massachusetts law); *Jones* v. *The Equitable Life Assurance Society of the United States,* 409 F. Supp. 370 (S.D.N.Y. 1975) (applying Massachusetts law); *Heit* v. *Brown,* 47 F.R.D. 33 (D. Mass. 1967); *Pomerantz* v. *Clark,* 101 F. Supp. 341 (D. Mass. 1951) (applying Massachusetts law); *Datz* v. *Keller,* 347 Mass. 766, 196 N.E.2d 922 (1964); *Braunstein* v. *Devine,* 337 Mass. 408, 149 N.E.2d 628 (1958); *S. Solomont & Sons Trust, Inc.* v. *New England Theatres Operating Corp.,* 326 Mass. 99, 93 N.E.2d 241 (1950); *Almy* v. *Almy, Bigelow & Washburn, Inc.,* 235 Mass. 227, 126 N.E. 419 (1920); *Bartlett* v. *New York, N.H. & H.R. Co.,* 221 Mass. 530, 109 N.E. 452 (1915); *Von Arnim* v. *American Tube Works,* 188 Mass. 515, 74 N.E. 680 (1905); *Dunphy* v. *Travelers' Newspaper Ass'n.,* 146 Mass. 495, 16 N.E. 426 (1888); *Greenspun* v. *Lindley,* 44 A.D. 2d 20, 352 N.Y.S. 2d 633 (1st Dep't 1974), *aff'd on other grounds,* 36 N.Y.2d 473, 369 N.Y.S.2d 123 (1975) (applying Massachusetts law); *Wachtel* v. *Baker,* Civ. No. 14772/73 (Sup. Ct., N.Y. Co. 1975) (applying Massachusetts law).

C. The General Policies of the Federal Securities Laws Are Not Impeded by the Shareholder Demand Requirement—a Substantial Question Is Not Presented

Petitioner argues that since the federal shareholder demand requirement sets certain preconditions to the right of a single shareholder to bring a derivative action under the federal securities laws it is therefore in conflict with those laws (Pet., pp. 13-16). The fact is, however, that both Rule 23 and Rule 23.1 were *designed* to place specific limitations on plaintiffs seeking to embroil their corporations in litigation through class and derivative actions. *E.g., Surowitz* v. *Hilton Hotels Corp.*, 383 U.S. 363, 371, *reh. denied*, 384 U.S. 915 (1966). Congress was presumably well aware of the federal shareholder demand requirements when it passed the Securities Act of 1933 and the Securities Exchange Act of 1934: *Hawes* v. *Oakland*, 104 U.S. 450 (1882), embodying the principle of shareholder demand, was decided almost 50 years prior to the passage of these laws, and the applicability of these requirements to federal enactments was made clear in *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U.S. 261 (1917). Congress could have passed legislation which would have provided that the right of a shareholder to bring a stockholder derivative action under the federal securities laws would not be subject to curtailment by the corporation's shareholders. Since there is no indication that Congress intended to exempt litigation under the federal securities laws from the requirements of Rule 23.1 it would be error to do so now under the guise of judicial construction. *See Davies Warehouse Co.* v. *Bowles, Price Administrator*, 321 U.S. 144 (1944).

Implicit in the policy behind Rule 23.1 is the recognition that derivative actions are potentially extremely costly to the corporation both in terms of management's time and attorneys' fees. Since this is a substantial multi-defendant

case, if the suit goes forward the Trust can reasonably expect to go through a period of extensive discovery, a long trial and, if necessary, an appeal. If petitioner is unsuccessful in proving his claims, the indemnification provisions in the Trust's Declaration of Trust provide that the Trust will also be liable for all the attorneys' fees and expenses of the Trustee defendants. The Court can take judicial notice that the cost of this litigation will run into the tens of thousands of dollars which must, of course, ultimately be absorbed by all the shareholders of the Trust. On the other hand, the financial expense to the petitioner of making a demand on the Trust's shareholders is hardly comparable: at present postal rates, it will cost $1,040 to send a mailing to the Trust's approximately 8,000 shareholders not counting whatever minimal expense would be involved in preparing the material.

Many courts have recognized that the extra cost and effort involved in communicating with a corporation's shareholders are outweighed by the policy of allowing the shareholders to exercise their informed business judgment against frivolous lawsuits. *See, Pomerantz* v. *Clark*, 101 F. Supp. 341 (D. Mass. 1951); *Jones* v. *The Equitable Life Assurance Society of the United States*, 409 F. Supp. 370 (S.D.N.Y. 1975); *Bruce & Co.* v. *Bothwell*, 8 F.R.D. 45 (S.D. N.Y. 1948). The claim of undue burden as a basis for excusing shareholder demand has also been rejected in the Fifth Circuit (*Stone* v. *Holly Hill Fruit Products, Inc.*, 56 F.2d 553 (5th Cir. 1932)), the Sixth Circuit (*Haffer* v. *Voit*, 219 F.2d 704 (6th Cir. 1955)) and the Eighth Circuit (*Quirke* v. *St. Louis-San Francisco Railway Co.*, 277 F.2d 705 (8th Cir. 1960)). *See also, Varanelli* v. *Wood*, 9 F.R.D. 61 (S.D.N.Y. 1949); *Greenspun* v. *Lindley*, 44 A.D. 2d 20, 352 N.Y.S.2d 633 (1st Dep't 1974), *aff'd on other grounds*, 36 N.Y.2d 473, 369 N.Y.S.2d 123 (1975); 3B Moore, *Federal Practice* ¶ 23.1.19 at 23.1-258 (2d ed. 1975).

There is no policy of the federal securities laws to promote unchecked litigation as petitioner claims. Rule 23.1 places important restrictions on the proper enforcement of the federal securities laws and is in accord with the policy of these laws to encourage informed decision-making by CIRI's shareholders.

D. The Purported Conflict in the Circuits Does Not Justify Granting the Writ

Petitioner incorrectly contends that the decision below is in direct conflict with the law of the Third Circuit (Pet., pp. 10-11, 13). The cases cited by petitioner establish no such conflict. In *Rogers* v. *American Can Co.*, 305 F.2d 297 (3d Cir. 1962), the Third Circuit approved the District Court's decision dismissing the plaintiff's complaint for failure to make a demand on shareholders. And *McClure* v. *Borne Chemical Co.*, 292 F.2d 824 (3d Cir. 1961) (state security for expenses statute), and *In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitr. Lit.*, 543 F.2d 1058 (3d Cir. 1976) (standing of an indenture trustee to object to a derivative settlement) do not involve the question of shareholder demand.

The *McClure* decision rests upon facts and reasoning unique to security for expense statutes. In that case, the Third Circuit accepted the view of Professors Hart and Wechsler that federal law is "interstitial" in character and that it "builds upon legal relationships established by the states." 292 F.2d at 831. The Court reasoned as follows:

> "One of the most important factors in those cases applying state law to federally-based causes of action has been a presumption that Congress has acted with established state doctrine in mind and has thus intended that state law be 'absorbed' into the federal statute. See, e.g., Davies Warehouse Co. v. Bowles, 1944, 321 U.S. 144, 64 S. Ct. 474, 88 L.Ed. 635. In the instant case, however, the Securities Exchange Act of 1934 was enacted over a decade before the first state security for expenses statute. It cannot be argued successfully therefore, that Congress had these statutes in mind as a background against which it enacted the Exchange Act." 292 F.2d at 833.

These facts are far different in the case of shareholder demand, which was recognized as early as 1882 in *Hawes* v. *Oakland*, 104 U.S. 450, over 50 years before the Securities Exchange Act of 1934 became law.

Unlike the security for expense statutes, the shareholder demand requirement is a fundamental and traditional principle of law finding support in numerous other jurisdictions. *Wathen* v. *Jackson Oil & Refining Company*, 235 U.S. 635 (1914); *Rogers* v. *American Can Co.*, 187 F. Supp. 532, 537 (D.N.J. 1960), *aff'd*, 305 F.2d 297 (3d Cir. 1962); *Quirke* v. *St. Louis-San Francisco Railway Co.*, 277 F.2d 705 (8th Cir.), *cert. denied*, 363 U.S. 845 (1960); *Haffer* v. *Voit*, 219 F.2d 704 (6th Cir. 1955); *Long* v. *Stites*, 88 F.2d 554 (6th Cir.), *cert. denied*, 301 U.S. 706 (1937); *Stone* v. *Holly Hill Fruit Products Inc.*, 56 F.2d 553 (5th Cir. 1932); *Watts* v. *Vanderbilt*, 45 F.2d 968 (2d Cir. 1930); *Heinz* v. *National Bank of Commerce*, 237 Fed. 942 (8th Cir. 1916); *Macon, D. & S. R. Co.* v. *Shailer*, 141 Fed. 585 (5th Cir. 1905); *Robinson* v. *West Virginia Loan Co.*, 90 Fed. 770 (C.C.D. W. Va. 1898); *Dannemeyer* v. *Coleman*, 11 Fed. 97 (C.C.D. Cal. 1882); *Varanelli* v. *Wood*, 9 F.R.D. 61 (S.D. N.Y. 1949); *Bruce & Co.* v. *Bothwell*, 8 F.R.D. 45 (S.D.N.Y. 1948); *Abraham* v. *Parkins*, 36 F. Supp. 238 (W.D. Pa. 1940); *Caldwell* v. *Eubanks*, 326 Mo. 185, 30 S.W.2d 976 (1930); and *Porter* v. *Mesilla Valley Cotton Products Co.*, 42 N.M. 217, 76 P.2d 937 (1937).

The only Court of Appeals decision arguably in conflict with the decision below is the First Circuit's decision in

Levitt v. *Johnson*, 334 F.2d 815 (1st Cir. 1964), *cert denied*, 379 U.S. 961 (1965). In *Levitt*, the court held that federal law governed the issue of shareholder demand in an action brought under the Investment Company Act of 1940, 15 U.S.C. § 80a-1, and that, where a company has a large number of shareholders, no such demand is required. *Levitt* is inconsistent with the Supreme Court's decisions in *Hawes* v. *Oakland*, 104 U.S. 450 (1882), *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U.S. 261 (1917), and *Price* v. *Gurney*, 324 U.S. 100 (1945), and with the language and judicial history of Rule 23.1.

Levitt tries to distinguish *United Copper Securities Co., supra*, where shareholder demand was required in a case under the Sherman Act, by stating that the policy of the antitrust laws is the protection of competing businesses, as businesses, while the Investment Company Act was designed to protect individual investors. 334 F.2d at 820, n. 5. Not only does this attempted distinction involve an unduly narrow statement of the policy behind the Sherman Act, *see e.g., Northern Pacific Railway Co.* v. *United States*, 356 U.S. 1, 4 (1958), but it leads to the extraordinary situation that under *Levitt* the requirement of shareholder demand is to be determined on a completely *ad hoc* basis depending on a federal court's interpretation of the policy behind a particular federal statute. Finally, its exemption of "large corporations" from the protection of Rule 23.1 has the unsupportable effect of differentiating between "large" and "small" corporations in a manner not authorized by Rule 23.1 or by any of the Supreme Court's decisions on this subject.

The continuing validity of *Levitt* in the First Circuit in cases alleging violation of the federal securities laws is brought into question by the later District Court decision in *In re Kauffman Mutual Fund Actions*, 56 F.R.D. 128

(D. Mass. 1972), *aff'd on other grounds*, 479 F.2d 257 (1st Cir.), *cert. denied*, 414 U.S. 857 (1973). In *Kauffman*, plaintiff brought derivative actions against sixty-five mutual funds and thirty-eight investment advisors managing these funds claiming violation of the federal antitrust laws, the Investment Company Act of 1940, the Securities Exchange Act of 1934 and the Investment Advisors Act of 1934. Two of the Massachusetts fund defendants moved to dismiss the antitrust claims on the ground that plaintiff had failed to make a shareholder demand under Rule 23.1. The District Court granted defendants' motion and rejected plaintiff's argument that shareholder demand was excused because the defendants' shareholders could not ratify the alleged wrongs and the requirement was impossibly burdensome. 56 F.R.D. at 136-140. The court distinguished *Levitt* on the ground that the First Circuit's decision was limited to cases brought under the Investment Company Act.

II.

The Second Circuit Court of Appeals Correctly Decided That the Transferee Court Is Not Required to Look to the Law of the Transferor Forum in Applying Rule 23.1.

Petitioner claims that the Court below, as the transferee court under 28 U.S.C. § 1404(a), should have applied the law which the transferor forum arguably would have applied and that this would have resulted in a refusal to construe Rule 23.1 as requiring application of Massachusetts law. (Pet., pp. 16-17). Under Petitioner's theory *every* issue in this litigation would be resolved by reference to another federal jurisdiction's laws. There is no rule of law supporting such an approach. If followed, it would produce wholesale forum shopping within the federal sys-

tem in cases involving antitrust and securities matters in which actions may be brought in virtually any district court in the country.

The whole point of *Van Dusen* v. *Barrack*, 376 U.S. 612 (1964), and the other cases upon which petitioner relies, is to preserve the principles established by *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), *Klaxon Co.* v. *Stentor Elec. Mfg. Co., Inc.*, 313 U.S. 487 (1941), and *Guaranty Trust Co.* v. *York*, 326 U.S. 99 (1945), that in diversity cases, the federal court should be no more than another court of the forum state, and that the state law of the transferor forum should apply. 376 U.S. at 637-39. The *Van Dusen* case, accordingly, stands only for the proposition that when convenience would be served by a transfer the plaintiff should not thereby lose the benefit of the substantive state law upon which his case is based.

These principles do not apply when the issue is an interpretation of *federal* law such as the construction of Rule 23.1. As Judge Lumbard (then Chief Judge) stated in *H. L. Green Co.* v. *MacMahon*, 312 F.2d 650 (2d Cir. 1962), *cert. denied*, 372 U.S. 928 (1963), which presaged the holding of *Van Dusen* v. *Barrack*:

> "[I]nsofar as the federal courts apply state law, they apply the laws of fifty separate jurisdictions, rather than one . . . . [A] plaintiff may not resist the transfer of his action to another district court on the ground that the transferee court will or may interpret federal law in a manner less favorable to him . . . . *The federal courts comprise a single system applying a single body of law, and no litigant has a right to have the interpretation of one federal court rather than that of another determine his case.*" 312 F.2d at 652. [Emphasis added.]

See also, Clayton v. *Warlick*, 232 F.2d 699, 706 (4th Cir. 1956); *Scheinbart* v. *Certain-Teed Products Corp.*, 367 F. Supp. 707, 711 (S.D.N.Y. 1973); *Polaroid Corporation* v. *Casselman*, 213 F. Supp. 379, 383-84 (S.D.N.Y. 1962). Any contrary interpretation would be completely destructive of the principle that federal district courts apply a uniform system of federal laws.

Finally, it should be noted that it is by no means clear that the Third Circuit, the transferor jurisdiction here, would dispense with shareholder demand in this case. In *Rogers* v. *American Can Co.*, 305 F.2d 297 (3d Cir. 1962), the Third Circuit approved the District Court's original decision which required that the plaintiff comply with the shareholder demand requirement before bringing suit under the Clayton Act. This is persuasive—if not conclusive—authority that the Third Circuit would also dismiss this case. *See also, Abraham* v. *Parkins*, 36 F. Supp. 238 (W.D. Pa. 1940) (suit dismissed for failure to comply with shareholder demand provisions of Rule 23(b)).

CONCLUSION

The Petition should be denied.

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